Service Date: November 8, 2000

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Application of	)	UTILITY DIVISION
MONTANA POWER COMPANY for	)	
Approval of its Electric Utility Restructuring	)	DOCKET NO. D97.7.90
Transition Plan Filed Pursuant to Senate Bill 390.	)	ORDER NO. 5986r

ORDER DENYING INTERIM RATE INCREASE FOR QF COSTS AND CONTINUING ACCOUNTING ORDER

Background

1. On August 24, 2000, Montana Power MPC (MPC) requested that the Montana Public Service Commission (Commission) approve an increase in the generation component of retail rates to allow recovery of increased Qualifying Facility-related (QF) supply costs. For customers that have moved to choice, MPC also proposed implementing a new or modified accounting order. MPC stated that timely regulatory action could take the form of interim approval as part of Docket No. D97.7.90.

2. MPC stated that current rates provide recovery for $36.5 million of QF costs, based on 1996 test period data. Since the rate moratorium took effect, MPC's QF-related supply costs have increased. MPC expects to incur $45.7 million of QF costs in 2000, an increase of $9.2 million. MPC asserted that it would suffer irreparable financial harm without regulatory treatment.

3. Section 69-8-211(6), Montana Code Annotated (MCA), provides for a rate moratorium for utilities restructuring pursuant to the "Electric Utility Industry Restructuring and Customer Choice Act" (Act), Title 69, Chapter 8, MCA. During the period from July 1998 through June 2002, MPC may not increase the electricity supply component of rates above the level reflected in rates on July 1, 1998. Section 69-8-211(7), MCA, identifies the exceptions to the rate moratorium, which include an extraordinary event that results in an eight-percent power supply-related revenue requirement increase from July 2000 through June 2002. MPC stated that

because it voluntarily reduced rates by $16.8 million in February that it could increase rates by up to $16.8 million without violating the rate moratorium requirements in the Act.

4. On September 12, 2000, the Commission issued a request for written comments to be filed by October 9 on MPC's proposed rate increase. Comments were received from MPC, Department of Environmental Quality (DEQ), Montana Consumer Counsel (MCC), Large Customer Group (LCG) and the U.S. Air Force/Malmstrom Air Force Base (MAFB).

Summary of Written Comments

Montana Power MPC (MPC)

5. MPC stated that the Act does not prevent it from increasing rates to reflect higher power supply costs. Section 69-8-211(6), MCA, allows MPC to increase rates for those customers who were given the opportunity to choose on July 1, 1998. MPC stated that when combined with the $16.8 million interim rate reduction, a $9.2 million increase for QF costs still results in an overall net decrease and, therefore, complies with the Act.

6. Section 69-3-304, MCA, provides that an order of the Commission approving or denying a temporary rate increase or decrease must be based on consistent standards appropriate for the nature of the case pending. Based on this statute, MPC stated that the Commission should not treat the QF rate increase request any differently than the earlier rate reduction to reflect the elimination of regulatory assets.

Department of Environmental Quality (DEQ)

7. DEQ recommended that the Commission deny MPC's requested rate increase. The rate moratorium requirement precludes increases in supply-related costs until 2002, and MPC does not meet the requirements for an exception. DEQ asserted that contractual and known QF cost escalation is inconsistent with a plain reading of the term "extraordinary event," and therefore is not exempt from the rate moratorium requirement. However, even if the increases in QF costs could be considered an extraordinary event, DEQ stated that the amount of the increase would not qualify. In order for the extraordinary event to create an exemption from the rate moratorium, it must result in an eight-percent power supply-related annual revenue requirement increase from July 2000 through June 2002. Using MPC's purchases from PPL under the buyback, DEQ estimated MPC's supply-related revenue requirement would be $159,744,976. Noting that actual supply-related costs are higher, DEQ stated that, at most, the increase in QF

costs is 5.8 percent, which is insufficient to satisfy the requirements for an exemption from the rate moratorium.

8. DEQ challenged MPC's assertion of irreparable financial harm due to increased QF costs. DEQ pointed out that the supply market has turned extremely tight. The average firm price at Mid-Columbia for the period July through September was 13 cents per kWh. In contrast, the average cost of all MPC's QF contracts is about 5.7 cents per kWh. According to DEQ the QF contracts now look like valuable assets in the unregulated environment and there is no irreparable financial harm.

9. DEQ stated that the proposed interim increase to recover QF costs amounts to a one-year tracker. The Commission has rejected the use of trackers for QF costs. DEQ stated that the Commission should not allow a piecemeal introduction of the tracker it has previously rejected.

Montana Consumer Counsel (MCC)

10. MCC stated that the Commission should reject MPC's request because it is a single-issue filing that fails to satisfy the minimum filing requirements pertaining to rate increase requests. The only current information MPC submitted with its filing relates to QF costs. Significant changes have occurred with MPC's generation asset sale. The majority of the production costs that formed the basis for current rates have been replaced with a power buyback rate. MCC stated that the Commission should not entertain a single issue filing that attempts to track one power cost component. MCC stated that, in general, the Commission has never approved power cost trackers for MPC. MCC cited Commission Order No. 5561a, Docket No. 91.6.24, wherein the Commission stated:

> The Commission is very sensitive to single issue filings. Given such, if MPC has concerns about QF cost escalations which will occur on July 1, 1992, MPC should request rate treatment for those increased costs within the context of its next general rate case and not as an isolated single issue.

11. MCC challenged the assertion that because MPC previously reduced rates by more than it now seeks to increase them, the request complies with the rate moratorium. According to MCC, MPC is attempting to use funds that should mitigate customers' stranded cost exposure to instead mitigate its power cost increase exposure. If MPC had not decided to sell its generation assets, the Commission could have issued a final restructuring order before July 1, 1998. All available mitigation would have been reflected in the order, and following the

order MPC's customers would have benefited because MPC would not have been able to seek recovery of QF power cost increases. MCC stated that ratepayers should not lose the benefits intended by the Act because a delay, due largely to MPC's own actions, has resulted in a final restructuring order being issued during the transition period. MCC stated that MPC's request would result in higher post-transition period CTCs because, had a final order been issued, the previous rate reduction would have been a reduction to CTCs and would not be available to offset future QF power cost increases.

12. The prior rate reduction, which MPC believes makes its proposal possible, is interim in nature. According to MCC, MPC cannot rely on an interim action to circumvent the restrictions on power cost increases during the rate moratorium period. The interim reduction is subject to modification and a modification should occur if higher long-term rates would result from the interim reduction.

Large Customer Group (LCG)

13. LCG urged the Commission to reject MPC's request. According to LCG, MPC's previous $16.8 million rate reduction had no impact on MPC's earnings because it was "paid for" by profits from the generation asset sale. In contrast, this QF power cost increase will not be offset by any asset sale proceeds and will directly increase MPC's bottom line. MPC claimed that the increased QF costs are having a financial impact but failed to present any supporting evidence or analysis. LCG asserted that, although MPC's earnings have decreased compared to 1999, this was expected given that its earnings base is smaller because of the generation asset sale. LCG stated that in an August 2000 report to the Securities and Exchange Commission MPC did not disclose any earnings warning due to increased QF costs. Further, MPC has made no claim of an "extraordinary event" pursuant to § 69-8-211, MCA.

14. LCG stated that utility rate increases are usually based on a test year that incorporates all changes affecting MPC's revenue requirement, including sales growth, and decreased costs as well as increased costs. LCG stated that MPC is requesting single-issue ratemaking, which has been disfavored by this and other utility commissions. MPC has focused on one component of its costs while ignoring the many other factors that influence its need for a rate increase.

15. MPC has focused on its QF-related power supply costs. LCG asserted that MPC has attempted to track these costs in the past. The Commission denied MPC's request for a QF

tracker in Docket No. D90.3.17, Order No. 5465d, referencing a previous order addressing the proper treatment of escalating QF costs:

> While the Commission is aware that QF escalations will occur each year, it is necessary to consider all of MPC's operations in the attempt to set rates at the appropriate level. As MPC is aware, there may in fact be cost changes that would cause rates to be reduced in a year's time (e.g., load growth beyond the test year). The Commission is very sensitive to single issue filing. Given that concern, if MPC has concerns about QF cost escalations which will occur on July 1, 1992, MPC should request rate treatment for those increased costs within the context of its next general electric rate case and not as an isolated single issue. (Docket No. 91.6.24, Interim Order 5561, page 3)

16. For customers who have opted for choice, MPC proposed a new or modified accounting order. LCG asserted that this proposal is unnecessary and incorrect. The accounting orders currently in effect provide a placeholder until transition costs and charges are finalized at the conclusion of this proceeding. LCG stated that a QF transition charge is as much a function of market prices as QF costs. MPC focused on the QF costs and ignored the fact that the current accounting order for QF transition charges is based on an assumed market price of 22 mills per kWh. MPC's proposed adjustment to the existing accounting order included an assumption that "in-market QF costs" are 22.25 mills per kWh. LCG asserted that this assumption is unsupportable given the current market for power in the Northwest where for the last twelve months market prices averaged more than 65 mills per kWh – higher than MPC's projected QF costs in 2000 or 2001. LCG charged that MPC is attempting to shift unrecoverable supply cost increases on to customers that have already left the system. MPC accepted the limitations on its financial recovery inherent in the rate moratorium as part of the compromise that led to passage of the Act. MPC should not now complain about the financial impact of the moratorium or try to recover those costs through the back door.

17. If the Commission chooses to modify the accounting order, then LCG recommended updating the complete equation. An updated accounting order should recognize today's market prices. LCG stated that this would cause the placeholder to become negative and would amount to a credit against MPC's deferred revenue claims from choice customers.

Malmstrom Air Force Base

18. MAFB stated that MPC seems to be mixing apples and oranges in its request to increase rates due to increased QF power costs. The fact that MPC earlier reduced supply-

related rates does not necessarily mean it should later be allowed to raise rates based on a different category of transition costs. MAFB asserted that MPC has not demonstrated that QF costs have been mitigated, and until it makes such a showing it is not entitled to a rate increase, per the statute.

Commission Decision

19. MPC asserted that the rate moratorium does not preclude its request. Pointing to § 69-8-211(6), MCA, MPC stated that the law does not prevent it from increasing power supply-related rates. If the rate moratorium provisions were limited to this single paragraph, MPC's argument might be valid. This paragraph speaks primarily to the level of rates and essentially precludes MPC from increasing the power-supply component of its rates above the level in effect on July 1, 1998. A reasonable interpretation of this particular paragraph might be that, since MPC previously reduced power supply rates below the level in effect on July 1, 1998, that it could now lawfully raise those rates back to the July 1, 1998 level.

20. However, a more complete interpretation of the rate moratorium and its relation to MPC's request must also consider the requirements in the next paragraph, § 69-8-211(7), MCA, which specifies exceptions to the rate moratorium and the relevance of MPC's revenue requirement. The timing of MPC's request and the nature of the costs involved mean that an exception to the requirements in § 69-8-211(6), MCA, would require MPC to demonstrate that an extraordinary event has resulted in an eight percent annual revenue requirement increase. As several parties stated, MPC did not include such a demonstration in its request and, therefore, cannot increase the power supply component of rates above the July 1, 1998 level based on an exception to the rate moratorium.

21. Still, this does not resolve the question of whether, since current power supply rates are less than the July 1, 1998 level, MPC can now raise rates back to that level or some lower level. Clearly, though, the Commission must be able to justify any rate increase it approves. Even assuming the Act would allow MPC to increase rates back to the July 1, 1998 level, the Commission should not approve a rate increase without a reasonable justification. MPC submitted that its QF-related power supply costs have continued to increase during the transition period and it faces irreparable financial harm without rate treatment. However, MPC has not demonstrated irreparable financial harm; its increased QF-related costs alone are not sufficient to justify a rate increase.

22. Throughout the D97.7.90 proceeding, MPC maintained that its revenue requirement should not be examined. The Commission and some intervenors, including MCC, asserted that proper functional separation, rate unbundling and the determination of transition costs required a comprehensive evaluation of MPC's embedded costs. In May 2000, the Second Judicial District Court confirmed that "[t]he Commission correctly interpreted the Act in holding that MPC's revenue requirement must be considered in Docket No. D97.7.90." (Cause No. DV-00-40, May 12, 2000, Findings of Fact, Conclusions of Law, and Order.) The Court also found that there are no express provisions in the Act limiting rate decreases, but there are provisions that severely limit, or freeze, rate increases. Following the District Court Decision, MPC filed an amended Tier 2 filing in June 2000, stating that revenue requirement issues are likely made moot by the generation asset sale and if there are revenue requirement issues they must be identified by intervenors. (Testimony of Jack Haffey, pp. 10-11.) In spite of its previous testimony, MPC now inappropriately seeks to introduce a narrowly construed revenue requirement issue for the purpose of increasing power supply-related rates during the transition period, when power supply rates are not to be increased.

23. MPC cannot justify its requested rate increase based only on increased QF costs. The Commission has traditionally rejected single-issue filings for good reasons. As MCC and LCG commented, load growth and the replacement of MPC-owned generation with a power buyback contract might also have affected MPC's costs and revenues. The positive and negative impacts of all these changes should be considered together in determining whether a rate increase is justified, even on an interim basis. In contrast to the previous $16.8 million rate reduction, which benefited customers and was not harmful to MPC (or else MPC wouldn't have proposed it), the current request increases costs to customers and might not be in the public interest. The Commission should ensure the rate increase is justified after a thorough evaluation of embedded costs and current revenues. If MPC is now going to raise this revenue requirement issue, it should file sufficient information to allow such an evaluation, as the District Court ordered.

24. Further, DEQ raised an interesting point about the relationship between current wholesale market prices and QF costs. MPC has the obligation to mitigate its costs wherever possible, whether they are transition costs or traditional utility operating costs. DEQ stated that over the last year market prices have averaged more than MPC's QF costs. Why has MPC not mitigated its QF costs by taking advantage of recent wholesale market conditions? MPC has

said that the QF production is used to serve residual non-choice load. But MPC also recently signed letters of intent to buy out certain QF contracts. The owners of at least one of these projects indicated that upon the buyout, they would sell their production either in wholesale or retail markets. Apparently, in that case, the production would not be available to MPC to serve non-choice load. The question is whether MPC has/had opportunities to mitigate increasing QF costs. This issue should be investigated further before MPC is allowed to increase rates during the rate moratorium period to recover QF costs.

25. MPC requested a new or modified accounting order for the customers who have opted for customer choice. On February 1, 2000, the Commission approved Order No. 5986o in Docket No. D97.7.90. In that order the Commission terminated the accounting order for regulatory assets and extended the accounting order for QF expenses to December 31, 2000.

26. Attached to the filing was a modified accounting order to treat the QF cost increase for customers who have opted for customer choice. In the draft accounting order MPC explained in Finding of Fact No. 8 that QF deferred revenues would be determined by multiplying the kWhs of the energy released at the meter by customers who opt for choice, by the charges shown in a table.

27. The Commission agrees with LCG’s reasoning on the matter of a modified accounting order for QF costs. There is no need to revise the formula in the current accounting order for QFs. The current accounting order is a placeholder until the Commission determines the final, fully mitigated net amount of transition costs in this proceeding. The Commission finds that the current accounting order for CTC-QF remains the proper method to track QF costs for customers who have gone to choice.

CONCLUSIONS OF LAW

1. Montana Power Company (MPC) provides electric utility service within the State of Montana and as such is a “public utility” within the meaning of . 69-3-101, MCA.

2. The Montana Public Service Commission (Commission) properly exercises jurisdiction over the Montana Power Company’s rates and operations pursuant to Title 69, Chapter 3, MCA.

3. The Commission has been further charged with the duty of overseeing MPC's restructuring of its utility business and its transition to customer choice of electricity supply, pursuant to Title 69, Chapter 8, MCA. Docket No. D97.7.90 is a case pending under this Title.

4. The Commission has the discretion, within the scope of § 69-3-304, MCA, to make temporary approvals of rate increases or decreases pending a hearing or final decision.

5. Based on standards appropriate for this case pending under Title 69, Chapter 8, MCA, on MPC's transition to choice and utility restructuring, the Commission properly exercises its discretion to deny the request for an interim rate increase to recover qualifying facility (QF) supply-related costs. MPC has not demonstrated irreparable harm. Its increased QF-related costs are not sufficient to justify a rate increase without a thorough examination of embedded costs and current revenues and a demonstration of efforts to mitigate these costs.

ORDER

WHEREFORE, THE COMMISSION DENIES the request for an interim rate increase of $9.2 million on an annual basis and the request for a modified accounting order. The Commission continues the existing accounting order in this Docket, ORDER NO. 5986o.

DONE AND DATED this 25th day of October, 2000 by a vote of 4 to 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

DAVE FISHER, Chairman

BOB ANDERSON, Commissioner

GARY FELAND, Commissioner

BOB ROWE, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.